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# Questions and Answers

In Preparation

For Co-Branded Programs

and

The ABA National Bank Card Conference

GOVERNMENT
DEPOSITION
EXHIBIT
1339

P-0306

## I: Strategy

- *What is MasterCard's business strategy?*

  MasterCard's Mission is:

  "To be the world's best payment service franchise by providing the best value to cardholders and merchants and superior profit growth opportunities for members".

  In order to achieve this, MasterCard will:

  -- Build a strong family of branded global payment services which deliver superior products and service benefits to cardholders.

    - MasterCard is the #2 credit brand worldwide, CIRRUS is a leading brand for global ATM acceptance and Maestro has been launched for point-of-sale debit.

  -- Maintain unsurpassed acceptance for all brands by providing superior business opportunities and services for merchants.

  -- Maintain the most efficient operations support through state-of-the-art authorization, clearing, settlement and risk management systems.

  -- Measure all investments in the franchise, both against their ability to strengthen the franchise, as well as to provide a payback to members.

  -- Meet local needs while maintaining global effectiveness by operating through six regions governed by regional boards which, in turn, are responsible to a global board.

- *How does this strategy benefit members?*

  MasterCard always recognizes that it was created by members to build their business and their profitability. MasterCard's mission and business strategies reflect this.

- *In what way has MasterCard responded to its eroding share position over the past 5 years?*

  MasterCard has:

  -- Strengthened the MasterCard brand through updating the mark, increasing both the level and effectiveness of its advertising, and positioning the brand as "providing value for the way we really live".

  -- Improved the quality of member service through an upgraded staff based in four regional offices.

- -- Acquired CIRRUS and built the MasterCard/CIRRUS ATM network to 90,000 ATMs in over 34 countries and territories. This network provides unsurpassed ATM cash access to cardholders of MasterCard cards and other cards bearing the CIRRUS mark, with superior reliability to any competitive system.

- -- Provided more timely and effective marketing programs for members, including the MasterValues program.

- -- Initiated a strong merchant program that has resulted in MasterCard playing a leading role in developing new merchant acceptance categories, particularly merchants where speed of check out is important, such as fast food, movies, parking and supermarkets.

- -- Instituted a number of programs to improve member profitability, such as leading the way towards increased issuer host authorization as the best way to reduce credit losses, leading the aggressive recovery of the full cost of interchange, and an aggressive audit program to reduce fraud, ready-to-implement programs to build retention and activation and help with recoveries.

- -- Initiated a legislative program to provide a stronger industry perspective to lawmakers and help coordinate members' individual legislative efforts.

- -- Established six operating regions with their own staff and governed by regional boards, in turn reporting to the global board.

• *What accounts for MasterCard's share stabilization over the past 18 months?*

- -- The large number of initiatives undertaken over the last four years have resulted in improved member confidence and support as they have seen member service improve, response rates increase and have reaped the benefits from programs to build member profitability. This has enabled MasterCard to get the member support needed to take share from competition.

• *With regards to MasterCard's business strategies, what is MasterCard's approach to....*

1. *Investment in systems development?*

-- *Why is MasterCard's outsourcing?*

Generally speaking, MasterCard is investigating the option that a third party specialist, such as a leader in the telecommunication industry, may be able to handle a portion of the networking or data processing function for Banknet at a lower cost than MasterCard, while bringing a level of value-added expertise to the strategic partnership.

If and when these criteria are met and such an outsourcing is forged, MasterCard will continue to maintain the quality and control of Banknet and ensure that members reap the benefits of rapid, quality advancement in network architecture while dedicating only a minimal amount of their overall capital to systems support.

-- *What aspects of MasterCard's system is being outsourced?*

We have looked at several areas but have concluded that only the network is a logical candidate for outsouring. MasterCard has partnered with a long distance carrier (AT&T) to provide network support and value added services worldwide.

-- *What is the benefit to members through outsourcing?*

The benefits are very clear. They are:

[illegible]

- improved uptime
- reduced costs
- more reliable networks
- faster delivery of enhancements - [illegible] at the least cost to members

-- *What is the risk of members losing control of their payment system through outsourcing?*

There is no risk at all. MasterCard still remains in total control.

-- *Who will be your vendors/partners in the outsourcing deal?*

We have only considered one vendor/partner and that is AT&T Long Lines.

FREUDIAN SLIP

-- *What role will this member/partner have in the management of the system?*
The relationship is one where the vendor/partner will take direction from MasterCard and only act on our behalf during emergency outages.

-- *Why was this vendor/partner selected?*

AT&T was selected because of their superior coverage on a global basis and because of its state of the art technical capabilities.

-- *What impact will the selection of this vendor/partner have on the relative competitive position of current or potential MasterCard members?*

Current members, particularly those in areas of the world where telephone service is not as good as in the U.S., will see marked improvements as we install VSAT service to them. As new members join MasterCard, they will experience first class telecommunication services anywhere they are in the world. Overall, both categories of members will find that value added services will be available to them, if they choose to use them. In the U.S., members will also be able to use our network for video teleconferencing within their own organizations.

2. *Increased investment in marketing?*

MasterCard has made a significant increase in marketing expenditures in the U.S. Total investment is $100 million in 1992 versus $78.4 million in 1991. A significant portion of this has been used to provide a year round national advertising program.

-- *Does MasterCard regard Visa as a competitor?*

Visa is a competitor, both for cardholders, as well as for the support of members. Because members issue both brands, MasterCard directs its cardholder strategies primarily against Discover and American Express. MasterCard believes the opportunity for members is maximized by putting a MasterCard and a Visa in every wallet.

-- *What happens to Visa in the event of an increasingly strong MasterCard brand?*

Visa's share growth has continued as MasterCard's share has stabilized. The result is that American Express has lost share and Discover share growth has slowed. Therefore, the bankcard industry is best served by two strong brands.

-- *Under duality, what are the risks/benefits to MasterCard members of a share shift which favors MasterCard over Visa?*

Members are interested in the combined share of MasterCard and Visa over outside competitors. In fact, since duality, both brands have grown rapidly, Visa has grown more rapidly than MasterCard and therefore has gained share, while MasterCard lost share, but this does not mean business was taken from MasterCard to Visa. In the future, providing both brands grow, shifts back and forth in share between MasterCard and Visa are not relevant unless they lose share to competition.

-- *How effective/efficient is MasterCard's current advertising?*

The "more value for the way we really live" positioning supported by the "Master The Moment" campaign has significantly raised MasterCard's advertising awareness since the third quarter of 1990 and maintained the brand's position in tracking study image ratings, while response rates have remained consistently strong.

-- *How much has Member Relations grown in the past several years and how have members benefited from that growth?*

Over the past three years MasterCard Member Relations has increased in numbers, expanded its scope and provided members with the most professional calling staff in the industry.

- The establishment of regional offices (New York, Chicago, Atlanta, San Ramon) has enabled MasterCard to reach out to the membership, better understand geographic/regional needs, and deliver quick and efficient quality service.

- The expansion of staff has enabled MasterCard to meet the unique needs of issuers, acquirers, and processors. And, where applicable, dedicate an account representative to members of sufficient size thereby maximizing effectiveness.

- Members today are called on more frequently (almost daily), by extremely knowledgeable and most helpful relationship managers who focus on member needs.

- More than ever before statistical, research and industry information is disseminated to the membership thereby enabling quick reaction to key events.

- Programs focusing on key member profitability issues such as increasing retention, improving recoveries, and maximizing direct mail response have been brought to the membership by member relations. And new programs are continually being developed based upon member input.

- Member Relations has evolved from being "sales" oriented to becoming true business partners with their assigned accounts.

**Member Relations Growth**

| | 1989A | 1992E | Growth | % Growth |
|---|---|---|---|---|
| Headcount | 18 | 53 | 35 | 194% |
| Expense | 4M | 12.5M | 8.5M | 213% |

Can we do more of this – it documents what representatives are doing / have done

-- *How efficient/effective has MasterCard's investment in merchant and acquirer relations been?*

MasterCard has restructured and expanded its acquirer member participation in each regional office within the U.S. Region. To date, in 1992, we have given overview presentations to over 150 acquirers. Each regional office is now equipped to handle most acquirer issues on their premises, offering quick response to member needs.

In our merchant acceptance area we have accomplished the following: After measuring the positive results of Forest For Our Future in the mail order/telephone order category, we have expanded our '92-'93 program to at least 70 catalog operations. This usage program is the most comprehensive package available to this important segment of the credit card industry. MasterCard has also targeted the healthcare industry with particular focus on doctors and dentists. A complete program to stimulate usage in these areas will be announced in early fall 1992.

Our supermarket program is up and very well accepted. Within the first six months we have penetrated 20% of qualified locations. In each test case, MasterCard has gained market share against other bank cards and has moved significant volume from cash/check to credit.

In our quick pay initiatives, we have established acceptance in two fast food outlets—Domino's and Pizza Hut. Both of these chains will be expanding the acceptance of MasterCard credit cards with national and regional programs. We successfully tested the acceptance of MasterCard credit cards in movie theaters. Based on the positive result, two national chains will add at least six more markets to this new category. An exclusive for MasterCard.

In retail markets we have nearly tripled the number of participating merchants for our summer and holiday MasterValues program. In addition, MasterCard Acceptance staff put together a regional business building test with the Melville Corporation that will run through the September period. This is an exclusive MasterCard event with this 8.7 billion dollar chain. Our travel market area has developed two regional destination programs in San Antonio and San Diego. Early results indicate significant share shift to MasterCard from participating merchants.

Additionally, MasterCard credit cards will be accepted at Royal Caribbean Cruise Line for the first time beginning in the fourth quarter of this year.

A brand awareness program, available to our restaurant merchants that includes bill presenters, tip trays and table crumbers distributed through their acquirers, has been extremely well received. Additionally, MasterCard staff presented a "teach-in" on customer service, the single largest deterrent to patron satisfaction based on a national poll conducted by MasterCard. Over thirty restaurants participated in this full day event that will be expanded to several markets early in 1993.

-- *How effective/efficient has MasterValues been in benefiting members and cardholders?*

MasterValues is a turnkey marketing program for members which gives them the opportunity to provide their cardholders with immediate and meaningful savings on merchandise and services. Primarily a usage program, members are increasingly leveraging MasterValues as an acquisition tool as well. As MasterValues continues to grow and build on the equity already established among merchants and cardholders, members are able to deliver more values to cardholders from an increasing number of merchants with appeal to diverse audiences and geographies.

MasterCard offers members the following support to help maximize participation in MasterValues:

- Low cost statement inserts designed in a promotional format to stimulate usage

- Full color customization of inserts to reinforce member's own program

- Full complement of in-branch signage materials

- National advertising support

- National PR support

- Customer Service Representative Training/Materials

Merchants reporting fourth quarter '91 MasterValues results experienced increased average transaction size, increased MasterCard share and volume. Additionally, results from quantitative cardholder research indicates that MasterValues positively impacts consumer feelings toward both MasterCard and their issuer; cardholders also see MasterValues as a "good benefit" for MasterCard cardholders. This research also indicates that cardholders most likely to participate are more likely to also be revolvers.

-- *What consideration have merchants received to secure their participation in MasterValues?*

MasterValues is a strategic alliance between MasterCard and participating members of our merchant community. We have never paid merchants to participate, nor have we charged merchants a participation fee.

The MasterValues program is a fully integrated marketing program which offers many benefits to merchant partners. In addition to member-delivered MasterValues coupon inserts and a MasterCard-sponsored free standing insert which also delivers partners' offers, the program is supported with national advertising and public relations programs. MasterValues partners also receive, at no charge, a full complement of customized point-of-sale materials.

Participating MasterValues merchants in turn are required to provide the following:

- Meaningful savings at the point of sale

- Employee training

- Sales results

- Promotion of their MasterValues offer in their "best promotion vehicle"

3. *The use of partnerships to support the long term interests of members?*

-- *What role do partnerships play in MasterCard's business strategy?*

MasterCard believes that partnerships provide good business opportunities where they add value or create more efficient means of achieving goals than building what they provide from scratch. A good example is our partnership with Eurocard in Europe, where MasterCard gained access to Eurocard's merchant acceptance network and a shared identity with their cardholders, and where CIRRUS will be marketed to the European financial industry. This relationship is now being expanded to debit through Eurocard's new parent company, Europay, and the eurocheque systems. This partnership appears to offer greater potential for European members and for strengthening the overall system that Visa's strategy of building their brand on a stand-alone basis. Another example is co-branding, in which a partnership between the issuer and the co-brander can generate added value to the cardholder and therefore better business opportunities for both partners.

-- *What are the risks/benefits to traditional members?*

As in any partnership, there are risks associated with the partners not achieving their expectations. Those risks are most effectively managed by ensuring that both partners have common goals and that both will gain from a successful partnership. Many businesses find that they can be more successful through partnerships and that the control benefits of wholly owned operations are often illusionary.

-- *Comparing and contrasting MasterCard's affinity and co-branding rules relative to Visa, what are the respective risks/benefits to members?*

MasterCard engaged in a long and comprehensive review of all aspects of co-branding, a review of well over a year's duration, prior to the drafting and passage of our co-branding rules by the Board of Directors in November of 1990. We were pleased to see that Visa's own recently initiated review on this subject appears to have concluded that MasterCard's leadership in this area was in fact the correct one for the industry, as evidenced by their passage of rules that are virtually identical to our own in February of 1992.

There are only two areas in which Visa differed in any way whatsoever from either the precise wording or intent of our co-branding rules. One of those areas is that Visa has effectively "grandfathered" all existing co-branding programs, in effect stating that any co-branding programs initiated prior to February 10, 1992 do not have to abide by their set of rules. MasterCard, in contrast, requires that <u>all</u> co-branding programs, regardless of when they were initiated, must come into compliance with our rules. We happen to believe that this position offers the greatest benefit to our membership. It ensures that MasterCard's rules will be applied consistently to all programs, and that a member that wants to offer a co-branding program after a particular date will be on the same level playing field with any co-branding programs offered prior to a given date. We believe Visa's "grandfathering" is, therefore, a potentially risky decision, one that we have carefully chosen not to make.

The second and only other area of difference between MasterCard's position adopted at the end of 1990 and the Visa rules passed in February of 1992 is with respect to the issue of the co-branded "separate account." MasterCard's overriding priority for this market area is and has always been the conversion of proprietary account volume into MasterCard volume for our membership. Our lengthy review of co-branding and our focus on this priority is what led us to conclude that the ability to offer a separate account option was critical to bankcard penetration of private label programs. It is important to remember in this context that only existing private label programs qualify for this separate account option.

Discussions with numerous members and private label issuers indicated that one of the primary reasons many private label issuers had chosen not to co-brand was fear of loss of sales. This fear centered around concerns that a co-branded bankcard might assist customers in financing purchases at other locations while diminishing their ability to obtain credit for sales at their own locations. The oftstated co-branding "nightmare" for many private label issuers was of a co-branded bankcard in which customers were provided with less credit than they had on their private label card, which they would then use at other merchant locations, finally arriving at the co-branded location without any open credit to use. No matter how farfetched such a scenario seems, it was a clearly persuasive one for the many private label issuers who had decided not to engage in co-branding.

In addressing this issue, MasterCard felt that the separate account option was and is a legitimate "bridge" for converting private label volume into member owned and controlled MasterCard volume. It allows our membership to offer a means of ameliorating the concerns many private label issuers have on co-branding vis-a-vis loss of customer relationships and sales. At the same time, it enables private label issuers to gain experience with co-branding and to understand that a close working relationship with a member offers many benefits to the co-brander. Most potential co-branders with private label programs would like to be out of the card business altogether, preferring to concentrate on their core business instead. Once such private label programs are "in the door" and they have had experience with co-branding and member partnership, we fully expect in most instances that full conversion will take place. To that end, we have also put in place financial incentives for full conversation, in the form of a 5 year assessment phase-in for any such conversion.

In sum, we feel that there is huge potential benefit for our membership, in the form of private label conversion, by having a separate account option for existing private label programs. By limiting this option to existing programs only, we feel we have greatly minimized any potential risk.

Our focus was, is, and always has been increasing the potential opportunities for our membership. Through lengthy review and careful deliberation, we feel we have maximized such opportunities with this set of rules. We are happy to see that Visa agrees with our judgment in virtually every aspect of our co-branding policy. We believe that in our two areas of difference, namely the separate account option and our application of our rules to all co-branding programs regardless of inception, Visa will soon come to agree with our carefully deliberated approach as well.

-- *Does merchant failure or chargebacks represent greater risk to members in the case of a co-branded card with separate account access as compared with a co-branded account without such access?*

MasterCard has explicitly stated in its rules (section 8.05.6) that we assume no liability for any transactions which are effected at the co-brander's locations through the separate account option.

Given that this account is in fact a separate one, the co-branding merchant has by definition full liability for any chargebacks and/or disputes. While MasterCard must approve in advance the customer service arrangement between a member and the co-branding separate account partner, one of the obligations of the co-branding merchant under any such arrangement must be to provide its own dispute resolution mechanism, which it is fully liable for.

With respect to a merchant failure or bankruptcy, neither MasterCard nor its membership will have liability for separate account transactions, since again such transactions are by definition separate from the MasterCard system. Also, since such separate account transactions are allowed by MasterCard <u>only</u> at wholly owned co-branding merchant locations, the failure of a merchant would simply mean from a liability perspective that the merchant would in any event have liability only to themselves, with no other party eligible for claims.

All of these liability issues serve to reinforce to the co-branding merchant the benefits to be gained by a full conversion to MasterCard. Once the co-branding merchant has a level of trust and experience with co-branded bankcards, the arguments for full conversion - of which continuing merchant liability under separate accounts is only one - will, we feel, lead to such full conversion.

- *How does the interlocking circles strategy impact the equity which members have built into the MasterCard logo?*

The interlocking circles in MasterCard's logo are one of the most valuable and recognizable features of any trademark, in the same league as MacDonald's golden arches. This provides a unique opportunity to brand a family of payment service products that draw on the recognition and strong image, particularly of global reliability, that the MasterCard logo has achieved around the world, while permitting clear identification as separate products with different functionality. In turn, these products, starting with CIRRUS and Maestro, will increase familiarity with and reliance on brands carrying the interlocking circles, as they build and become successful. This strategy of building a family of products around a successful brand and interlinking them with a common identity is a much used and usually very successful marketing strategy.

## II: Technology

- *How competitive is MasterCard's decentralized network architecture relative to Visa's centralized system?*

  MasterCard's Banknet is far superior to Visa's VisaNet because of the following:

  - Peer to Peer architecture
  - Single backbone for all applications
  - On demand dial backup
  - Global standard
  - Dynamic adaptive routing
  - Public data network capability
  - Triple layered stand-in capability
  - Carrier style switching's telephone technology ready and waiting for very high capacity at lower cost

  This means MasterCard's Banknet provides:

  - *Convenience*
    A bank and merchant transaction process, which uses the most rapid technology available.

  - *Adaptability*
    Banknet's industry standard non-proprietary packet protocol meets with worldwide acceptance.

  - *Reliability*
    Banknet provides around the clock availability.

  - *Data Integrity*
    State of the art equipment and fiber optic cables transmit data accurately and quickly.

  - *Expandability*
    Carrier style switching means Banknet is ready and waiting to take advantage of the exploding technology that allows higher capacities at lower costs.

    All of these items combine to provide an even greater benefit: **Confidence**. Banknet's non-proprietary packet protocol, peer to peer architecture, dynamic adaptive routine, and triple layer protection means you can be confident of the fastest, most reliable, state of the art transmission of your electronic data 24 hours a day, 7 days a week, 52 weeks a year.

- *Does Banknet permit transactions to be reviewed at a central point?*

  We believe it is not necessary to do this but rather to put mechanisms in place to prevent invalid transactions to be sent member to member, causing an increased level of chargebacks. Presently, receipt of retrieval requests is the number one chargeback reason, accounting for 25% of all chargebacks. MasterCard's MasterCom system has drastically cut into this source of chargebacks by not allowing members to submit a chargeback for non-receipt if it was fulfilled through MasterCom. Over 80% of all retrieval requests worldwide are now handled through MasterCom.

- *Can Banknet offer...*

--risk identification?

--excessive chargeback monitoring?

--chargeback reduction?

--account tracking?

--MasterCard identifies daily to all issuers accounts that have either exceeded member parameters or, where transactions have occurred at a point of compromise. This has already saved our members millions of dollars.

--Excessive chargeback monitoring is done monthly by quality group within the U.S. Region. Those identified as problem members are identified and worked with.

--Chargeback reductions have been achieved under the MasterCom program.

the Member Protection Plan
--With regard to account tracking, MasterCard is moving to a methodology under ~~Project Omni~~ to identify individual transactions through their life cycle. It will use a combination of information available from the authorization record and will be compared with the clearing record when submitted.

- *Can Banknet achieve the scale efficiencies of Visanet's Supercenters in the future?*

MasterCard's approach to Banknet and worldwide support is one that doesn't require supercenters since it is available 99.999% of the time, and due to its packet switching capabilities requires less major hardware than does VisaNet. We are confident that our scale efficiencies already are better than VisaNet today and will be even better in the future.

- *Can Banknet provide members cost savings comparable to the Backoffice 2000 or Payment Service 2000 programs?*

Backoffice 2000 is Visa's attempt to catch up with MasterCard. It is their intent to create a MasterCom equivalent, provide host based authorizations, chargeback reductions and automatic updates to a cardholder database of pickup accounts.

MasterCard has been providing these services for years. MasterCom is a worldwide service.

We have been doing host based authorization for years because we were convinced that the issuer is in the best position to make a decision regarding his customer. Time has absolutely proven us to be correct. Visa is now following.

We are attacking the number one reason for chargebacks using MasterCom and have been very successful in reducing non-receipt chargebacks for all MasterCom participants. We will be adding more and more types in the very near future.

Finally, we update all our electronic (data base) files hourly to ensure total protection for the issuer and have been doing this for ten years.

- *Is Banknet based on obsolete IBM (Series One) technology?*

Banknet is state of the art in every respect. With its diverse routing, 100% guaranteed uptime, peer to peer delivery capabilities, multi layers of stand-in processing ~~for acquirers~~ and issuers, there is no equal. IBM series 1's are nothing more than input and output devices to the network. Upgrading them is required as we work to our future support requirements.

- *Does Banknet suffer disadvantages relative to Visa's PC-based system?*

The new NCR's which are being designed to replace our IBM series 1's are far superior to Visa's PC based system. They will offer significantly more capabilities for an equivalent cost. By the first quarter, 1993 we should have a replacement running at a members location.

- *Has/can MasterCard achieve systems parity with Visa by the year 2000? If so, at what cost?*

Because our systems are so diverse, it is difficult to measure one against the other. Our overall strategy is also very difficult to compare. MasterCard provides its members with a very cost effective delivery mechanism and has concentrated its efforts in the credit and debit card arenas. Visa has decided to be the number one transaction processor in the world. That comes with a very heavy overhead and a requirement for big hardware and systems to support them. MasterCard systems are clearly at parity with Visa today in the credit and debit worlds. However, we are investing $65 million in future enhancements while they are investing up to $300 million. It is obvious their strategy carries a much larger overhead than does ours, but ~~then~~ again we're not out to run the world, just to process effectively for our members.

over the same time frame as our $65 MM?

Need time frame - we will invest more over longer time frame

- *In summary, what are the benefits of Omni?*

While Visa dreams of ways to improve their perception with the member that they are the technology leaders, MasterCard has quietly "out-technologied" them. MasterCard has continued to develop systems geared to attacking industry problems. Daily velocity reporting to issuers has already saved the members millions of dollars. Determination of point of



Could we define this?

compromise locations worldwide, and the dissemination of this information has also reduced members' losses significantly in the area of counterfeit cards. Project Omni will deliver another two systems that, by year end, will give issuers and acquirers additional tools to further prevent fraud. As never received plastic fraud continues to skyrocket, MasterCard is creating a data base system that will help members avoid bad postal areas by delivering cards directly from the issuers to the cardholders' local post office for the cost of first class postage.

## III: Governance

- *How does MasterCard's board composition differ from Visa's board?*

**As of 1991**

| | As seen by MasterCard | | As seen by VISA | |
|---|---|---|---|---|
| | MasterCard U.S. Board | Visa USA Board | MasterCard U.S. Board | Visa USA Board |
| Brand volume of board members | $38B | $60B | $24B | $68B |
| % Board portfolio in Visa | 35% | 62% | 38% | 66% |
| % Board portfolio in MasterCard | 65% | 38% | 62% | 34% |
| %Board Gross $ Volume —Traditional Banks | 62% | 96% | 26% | 97% |
| %Board Gross $ Volume —Non-Traditional Banks | 38% | 4% | 74% | 3% |

- *Are non-banks disproportionately represented on MasterCard's board?*

MasterCard's founding members tended to be smaller banks than those which joined the Bank Americard franchise. This is reflected today by the fact that 6 of out of the 10 largest traditional bank issuers are on the Visa board. This is despite of the fact that the Visa board banks issue more MasterCard® cards than do the MasterCard board banks. The board composition of the associations reflects more historical relationships before duality than their issuance of brands. MasterCard's higher board representation of non-traditional banks, generally newer members, had enabled MasterCard to be more fairly represented among all issuers, where MasterCard has 4 of the top 10 on its board and 4 of the next 10. Furthermore, MasterCard believes in equal treatment for all members and does not view it as a virtue to exclude from its board any members who support the brand well.

- *To what degree is bankcard profitability a consideration in the deliberation of MasterCard's U.S. board?*

The board supports the intent of our mission which is that the members are best served by a strong MasterCard franchise as a platform for the profitable growth of members. A strong franchise is best achieved by aggressive, growth-oriented members who will help the brand compete with outside competitors. The MasterCard board wants to be sure that the investment in the franchise by existing members is reflected in the cost of entry to new members. In fact, MasterCard was the first association to adjust entry fees upward to do this. New MasterCard programs are cost justified on the basis of their return to the membership. However, the board does not seek to insulate the profitability of individual members from the rigors of competition.

## IV; Maestro

- *Is MasterCard winning or losing in the off-line debit race?*

  We are winning because we are providing a product that is profitable to our members, and that they can use to segment their customer base and reward their best customers with added levels of convenience. This product continues to experience solid growth and MasterCard will continue to support current and new issuers of MasterCard Debit. And now that Visa Debit has unbundled its interchange rates, MasterCard Debit has a major advantage over Visa Debit -- approximately 40 basis points.

  MasterCard's overall debit strategy helps issuers to tailor off-line/on-line POS debit to complement their strategic plans, and we will support this approach because we believe it best serves our members. We will also promote both products and not just one since this approach favors our member banks more profitably.

- *How does Maestro stack up against Interlink by such measures as profitability/market control and potential to cannibalize off-line debit and credit transactions?*

  Maestro is positioned to be more acceptable and profitable then Interlink. Maestro was conceived and executed in alliance with our members and regional EFT networks. Its operating rules were recommended by these networks. This translates into much lower start-up and connectivity costs for our members. Interlink on the other hand, mandates the support of ISO 8583 message format and a full transaction set from day one of a member's program resulting in more extensive and expensive start-up costs.

  Maestro is deferring implementation of the CAP fee paid from the acquirer to the issuer until July, 1993. This allows issuers to build the value of the Maestro brand and, for acquirers, it provides an opportunity to participate in the only global on-line POS debit system. Maestro also encourages acquirers to add merchants by *not* charging a per-location fee.

  Maestro is positioned to gain fast brand recognition and market control through its MasterCard connection, primarily through utilization of the blue and red interlocking circles. Visa's Interlink logo has limited consumer brand awareness and will require substantial promotional investment.

All of this, coupled with a lower fee schedule, adds up to a more profitable program for Maestro.

For most consumers, Maestro POS debit card use will not affect credit card use. POS debit issuers confirm that debit card users have higher-than-average credit card balances. Data also show that consumer spending with debit cards is different from spending with credit cards. There is a larger proportion of debit card volume as compared to credit card volume at restaurants, clothing and department stores, drugstores, gas stations, grocery stores, and hardware stores—merchants where "pay now" transactions are the norm. On the other hand, the proportion of credit card volume is greater for appliance purchases, mail orders, cash services, airlines, travel services, lodging, and auto rentals. Clearly, consumers are making conscious decisions as to which transactions they want to "pay later" with a credit card and which they prefer to "pay now" with a debit card.

A national POS program will not cannibalize off-line debit. Currently, regional network programs are growing rapidly and their marks are on off-line debit cards. Through these regional programs some gas and grocery transactions may now be processed as on-line where previously it may have been processed as off-line. This would occur even without a national POS program.

- *Why has MasterCard chosen to go the route of working so closely with regional network?*

We chose to work with the regionals because this alliance produced the best mutual benefits for our common bank members. We continue to work with them because POS debit growth will mirror the growth of ATMs that started on a local level and migrated to regional, and now national and international levels. It enables us to build a national system with national expertise and infrastructure. Banks set up the regional networks to facilitate EFT (both ATM and POS), and have the necessary operational connections to banks' DDA accounts. The regionals have been very successful in promoting and managing the ATM growth and we look forward to this same success on the POS side.

Maestro is a market driven product; it is being developed in alliance with bank-owned regionals, representative of their member banks, to meet the needs for on-line POS. It is important to realize that successful POS debit programs will begin at the regional level.

- *Do the interests of regional networks coincide with those of issuing members, especially by such standards as card profitability?*

The interests of regional networks do coincide with those of issuing members since issuers constitute their ownership. They also offer issuing members larger card and merchant bases as well as increased transaction volume. Developing local and regional POS programs is further strengthening the profitability of an issuers deposit account by encouraging customers to maintain higher checking balances to keep funds available for purchases, decreasing the number of payments by check at merchants and the number of ATM transactions and most of all, creating opportunities for increased revenue through new card transaction fees. The point-of-sale conveniences that a regional network offers through EFT helps an issuer get debit cards into the hands of customers who do not currently use machines (ATM) for their banking needs. A regional network point-of-services increases customer loyalty for an issuers deposit accounts—thereby protecting and expanding an issuers market share.

- *How well does the Maestro board...*

-- *compare/contrast with Interlink board?*

The Maestro board is comprised of 23 directors:

- 10 Financial Institution Bankers
- 10 Regional EFT Networks Representatives
- 1 President of Maestro U.S.A., Inc.
- 2 MasterCard Executives

All decisions regarding Maestro policy are made by the Maestro U.S.A. Board of Directors. The MasterCard Board of Directors does not have veto power. The board members have one vote each.

The Interlink board is comprised of 24 directors:

- 16 Financial Institution Bankers
- 4 Interlink Network Founder Bankers
- 1 Regional EFT Network Representative
- 3 Visa Executives

The Visa U.S.A. board must approve all pricing decisions, the budget, and operating rules that are recommended to the Interlink Board of Directors. Interlink's allocation of board votes is dependent upon the annual volume of Interlink transactions. Based on the existing transaction volume of the California banks, it is unlikely that banks outside of the original four will have voting clout equal to the original owners.

-- *represent issuers versus networks?*

The top 125 debit card issuers issue only 36% of all debit cards, with the balance issued by the 12,000 banks in the U.S. Seventy-six percent of all debit cards are in the top 25 regional networks. Maestro U.S.A. was built as a true national system whose objective is to provide a complementary national POS system to the regional network's POS systems owned by the members Maestro U.S.A. is serving. Financial institutions have made significant contributions in capitalization, technical and marketing resources to build these regional EFT networks.

Interlink was developed by four California financial institutions and was held exclusively by the California banking community until its purchase by Visa. Visa's aim is to use this regionally built POS system as a basis for their national POS system. They have assigned all of their board seats to either Interlink's founding members or Visa board banks and one regional EFT network.

We believe Maestro better represents the majority of issuers and regional banks. Our goal is to support their investment in the regional networks by offering a global consumer payment system.

- *Have Maestro service levels been set with the needs of merchants and consumers in mind, or are they simply based on ATM models?*

The development of appropriate service levels to consumers and merchants in Maestro utilized the experience gained in the delivery of ATM services worldwide, as well as the successful roll-out of local and regional debit POS programs. This experience, applied to the specific environment requirements of national and global debit point-of-sale, has led to the development of a package of services and requirements that will deliver superior service levels.

Some key points must be understood. First, since Maestro (and Interlink) will utilize the existing national and local ATM and POS infrastructure, service level requirements are necessarily integrated into these systems. This alone would not be necessarily insufficient as these systems today are delivering quality, timely and reliable service millions of times a day.

Second, service level delivery involves many components and requires a closely managed process on an ongoing basis to ensure maximum service to the consumer and the merchant.

Third, our measurement of service level is to provide the maximum level of correct, timely responses to the consumer and the merchant. This includes denying those who should be denied but only when they should be denied.

- *Compare/contrast Maestro service levels with Interlink's in so far as they meet the needs of consumers, members and merchants.*

In the normal transaction, a request is sent to the card issuer and approved or denied based on the availability of funds, with an appropriate response being sent to the acquirer. This is typically accomplished in 5 to 10 seconds total time, from the consumer's perspective, based on the current national average. Remember also that 95+ percent of all transactions will tend to be more local in nature and generally involve fewer system components for even faster response time.

Therefore the issues that must be managed are slow response times and failures to one of the components. (This does not begin to describe the investments made and elaborate steps taken to maintain current component failure to around 0.1 percent nationally.)

**Maestro**

95% of all transactions are required to be responded to in 10 seconds (general experience at national level is 4 to 5 seconds average response time). Response time in a network is a managed process, not one artificially created by timing barriers. Maestro sets a 25 second timer at the Switch to allow the occasional transaction taking more than 10 seconds to be processed correctly.

Merchants and consumers are not adversely affected by the rare transaction that takes longer than 10 seconds. A customer and merchant are better served when a $205 purchase receives a 15 second approval rather than a 10 second denial as would be the case in Visa's environment. Remember, this consumer will likely try again or resort to an alternative payment mechanism, either of which takes much longer than 5 seconds.

**Interlink**

Visa has timers at their Switch set at 10 seconds—no average response time used—thus anytime transactions take 10 seconds or more stand-in is initiated (see Downtime Processing below). This will cause problems for networks with layers. Processing problems will also result due to the fact reversals will be required for transactions authorized by the issuer that reach the Visa Switch after 10 seconds, thus slowing additional traffic. Members and networks must evaluate developing additional timer capability for Interlink from that of other national and regional programs or error recovery may increase dramatically. There are serious questions whether this timer will stand in a full national roll-out let alone any possible international use.

**Downtime Options**

| Point of Failure | Maestro | Interlink |
|---|---|---|
| Issuer or between issuer and issuer network | Network stand-in Switch stand-in optional merchant authorization | Network stand-in Switch stand in? |
| Issuer network or between Switch and issuer network | Switch stand-in optional merchant authorization (1) | Switch stand-in mandatory (2) |
| Switch | Merchant authorization (3) On-line resubmission | Merchant authorization (4) (paper-based) |
| Acquirer network | Merchant authorization | Merchant authorization |
| Terminal itself | Alternate payment mechanism | Merchant payment mechanism |

--The Maestro switch will stand-in for an issuer at their option with PIN or no PIN. Flexibility exists for all standard PIN verification methods, variable stand-in limits, etc.

--Visa requires stand-in after 10 seconds for all cards with or without PIN with a minimum $200 daily limit. Limited to DES and Visa algorithm for PIN verification. If negative files and/or offset files used there is a .005 per account on file charge per month.

--Merchant authorization (at the merchant's risk) in Maestro can occur due to downtime at any point in the system (based on response code). Merchants resubmit the transactions on-line where they can be PIN-verified and subjected to the normal approval process.

--Merchant authorization (at the merchant's risk) in Interlink can occur only when the Interlink Switch, the merchant or terminal is down and be resubmitted as paper-based to Interlink (if there are very many this will be a handling problem) who will transmit them to the issuer. These transactions will appear as subsequent PIN-less transactions and development will be required of members.

- *What are the risks to U.S. members of signature-based authorization of Maestro in Europe?*

The risks are minimal. All Maestro International transactions at all terminals are on-line. Issuers have the option to deny transactions originating from terminals which do not have PIN entry. Signature for Maestro transactions is used at some terminals in only two countries -- U.K. and France. All other countries and many terminals in the U.K. and France accept PINs. We expect insignificant fraud losses due to signature in the U.K. and France.

Many security checks are available to ensure only properly encoded cards are utilized and the merchant is required to verify the signature. Daily limits, velocity checks and the like are all available to limit exposure. Stolen or lost cards, once reported, are unusable forever. Since transactions are seen and reported immediately, it is no different than an on-line transaction in the U.S. except that instead of the system verifying a PIN, a merchant verifies the signature. If they do not, the transaction may be charged back to the acquirer. Remember, too, the few European countries that allow this are much more security conscious than their U.S. counterparts. Also these terminals will diminish over time. Additionally a higher interchange rate is paid to issuers for these transactions.

Given the number of transactions there is a much greater risk in the U.S. on transactions authorized by a system in a downtime processing mode.

RW:kcs

5. Question: How did the worldwide ICA picture in 1970 compare to your BankAmericard (now Visa) competitors?

Answer: Bank of America at that time had a subsidiary through which it had marketed BankAmericard outside the United States. Shortly after I came aboard, according to the published reports, it had a large number of merchants and cardholders in a considerable number of countries outside the United States, including Barclay card in England and Chargex in Canada in July 1970.

6. Question: Did Interbank have an interest in international expansion? If so, when did this manifest itself?

Answer: There was a growing desire in 1970 on the part of some influential members and directors to expand abroad but no staff available to make the effort.

7. Question: Did you then set priorities as to areas in which to expand?

Answer: Yes.

8. Question: What areas were your priorities?

Answer: An important one always was Canada. From the beginning of Interbank, long before I joined the organization, there had been interest in signing the four major banks in Canada who were known in 1968 to be forming a charge card association, later to become Chargex. Another was Europe. In the fall of 1970 Interbank hosted a meeting in Paris, attended by a considerable number of banks interested in the charge card business. It was there that we singled out the real number 1 prospect (in Europe, certainly) the 3 major banks in England who were beginning to show an interest in entering the business in competition with Barclays, the BankAmericard bank.